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COMPILING AND REPORTING FY 2000 NAVY WORKING
CAPITAL FUND INTRAGOVERNMENTAL TRANSACTIONS

Report No. D-2001-139

June 18, 2001

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Department of Defense

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Abstract We conducted this audit in support of our annual audit of the DoD Agency-Wide financial statements for FY 2000, as required by the Chief Financial Officers Act of 1990, as amended by the Federal Financial Management Act of 1994. This report is the fourth report in a series on the FY 2000 Navy Working Capital Fund Financial Statements. The previous reports discussed inventory valuation, problems with a financial feeder system, and endorsed the Naval Audit Service disclaimer of opinion on the financial statements. The FY 2000 Navy Working Capital Fund Financial Statements reported \$25.1 billion in assets, \$6 billion in liabilities, \$19.1 billion in net position, and \$18.3 billion in intragovernmental transactions. Intragovernmental transactions are transactions that occur within and among general fund and working capital fund organizations, DoD, and the Federal Government. These intragovernmental transactions should be identified and eliminated, as appropriate, when an entity prepares consolidated financial statements.		
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Acronyms

CDB	Central Data Base
DFAS	Defense Finance and Accounting Service
JV	Journal Voucher
SSR	Summary Source of Revenue



INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
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June 18, 2001

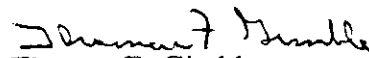
MEMORANDUM FOR DIRECTOR, DEFENSE FINANCE AND ACCOUNTING
SERVICE
NAVAL INSPECTOR GENERAL

SUBJECT: Audit Report on Compiling and Reporting FY 2000 Navy Working Capital
Fund Intragovernmental Transactions (Report No. D-2001-139)

We are providing this report for review and comment. We conducted this audit in support of our audit of DoD Agency-Wide financial statements for FY 2000 as required by the Chief Financial Officers Act of 1990, as amended by the Federal Financial Management Act of 1994. We considered comments from the Defense Finance and Accounting Service on a draft of this report in preparing the final report.

DoD Directive 7650.3 requires that all recommendations be resolved promptly. The Assistant Secretary of the Navy (Financial Management and Comptroller) did not comment on the draft of this report. Therefore, we request that the Assistant Secretary of the Navy (Financial Management and Comptroller) provide comments on the final report by July 18, 2001.

We appreciate the courtesies extended to the audit staff. Questions on the audit should be directed to Mr. Marvin L. Peek at (703) 604-9587 (DSN 664-9587) (mpeek@dodig.osd.mil) or Mr. Hoa H. Pham at (703) 604-9588 (DSN 664-9588) (hpham@dodig.osd.mil). See Appendix B for the report distribution. The audit team members are listed inside the back cover.


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Office of the Inspector General, DoD

Report No. D-2001-139

(Project No. D2000FC-0279.002)

June 18, 2001

Compiling and Reporting FY 2000 Navy Working Capital Fund Intragovernmental Transactions

Executive Summary

Introduction. We conducted this audit in support of our annual audit of the DoD Agency-Wide financial statements for FY 2000, as required by the Chief Financial Officers Act of 1990, as amended by the Federal Financial Management Act of 1994. This report is the fourth report in a series on the FY 2000 Navy Working Capital Fund Financial Statements. The previous reports discussed inventory valuation, problems with a financial feeder system, and endorsed the Naval Audit Service disclaimer of opinion on the financial statements. The FY 2000 Navy Working Capital Fund Financial Statements reported \$25.1 billion in assets, \$6 billion in liabilities, \$19.1 billion in net position, and \$18.3 billion in intragovernmental transactions. Intragovernmental transactions are transactions that occur within and among general fund and working capital fund organizations, DoD, and the Federal Government. These intragovernmental transactions should be identified and eliminated, as appropriate, when an entity prepares consolidated financial statements.

Objectives. The audit objective was to determine the reliability and effectiveness of the processes and procedures used to compile and prepare intragovernmental transactions for the FY 2000 Navy Working Capital Fund Financial Statements. We also reviewed the Defense Finance and Accounting Service (DFAS) Cleveland management control program as it related to the audit objective.

Results. The Navy and DFAS identified \$18.3 billion in intragovernmental transactions, which included \$4.7 billion that was eliminated from the FY 2000 Navy Working Capital Fund Financial Statements. DFAS Cleveland also published a standard operating procedure providing guidance on how to gather, process, and report intragovernmental transactions. However, additional improvements were necessary.

Review of 151 of the 173 department-level journal vouchers to record and adjust financial data related to FY 2000 intragovernmental transactions for the Navy Working Capital Fund showed that 95 journal vouchers, valued at \$28.8 billion, were not adequately supported because DFAS forced buyer-side data to agree with seller-side data without reconciling the differences, as directed by the Under Secretary of Defense (Comptroller). Also, DFAS Cleveland did not disclose in a note to the financial statements that accounts receivable and revenue were increased by \$295 million each to remove abnormal balances caused by adjustments for undistributed collections. As a

result, the financial statements were not reliable. Until accounting systems can capture trading partner data and reconciliations between buyers and sellers can be performed, financial statements will continue to be unreliable (finding A).

Intragovernmental eliminations in the FY 2000 Navy Working Capital Fund Financial Statements were overstated by \$1.8 billion plus a potential additional amount up to \$2.2 billion. Also, the financial statements did not disclose that complete information relating to intragovernmental transactions had not been received and that intragovernmental transactions submitted by Norfolk Naval Shipyard were not accurate. DFAS Cleveland did not receive seller-side information from 11 of 46 Navy Working Capital Fund field organizations required to provide seller-side information, and DFAS Cleveland incorrectly compiled and allocated seller-side information, which resulted in the overstatement of intragovernmental eliminations. As a result, the FY 2000 Navy Working Capital Fund Financial Statements were materially misstated and could not be relied on as a complete and accurate presentation of financial reporting (finding B). See Appendix A for a discussion of the review of the management control program.

Summary of Recommendations. We recommend that the Director, DFAS Cleveland, disclose adjustments to accounts receivable and revenue for unreconciled amounts of undistributed collections and any departures from reporting requirements, and improve management controls to review and edit all information received to ensure that information received is properly recorded, reviewed, and accounted for. We also recommend that the Assistant Secretary of the Navy (Financial Management and Comptroller) require Navy Working Capital Fund Industrial Fund organizations to provide DFAS Cleveland with complete and accurate seller-side information as required by the DoD Financial Management Regulation.

Management Comments. DFAS concurred with all recommendations and agreed to make appropriate disclosures in the notes to the financial statements for adjustments to remove abnormal balances caused by posting undistributed collections to accounts receivable and disclose methods used to allocate seller-side balances for organizations that do not submit required information. DFAS also will improve procedures and controls to ensure information from Navy Working Capital Fund field organizations is properly recorded, reviewed, and accounted for. The Navy did not respond to the draft of this report. Therefore, we request the Navy provide comments on the final report by July 18, 2001. See the Management Comments section of the report for the complete text of the comments.

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Background

Public Law 101-576, the “Chief Financial Officers Act of 1990,” November 15, 1990, as amended by Public Law 103-356, the “Federal Financial Management Act of 1994,” October 13, 1994, requires DoD to submit to the Office of Management and Budget annual financial statements that have been audited by the Inspector General, DoD. This report is the fourth in a series of reports related to the FY 2000 Navy Working Capital Fund Financial Statements. The previous reports discussed inventory valuation, problems with a financial feeder system, and endorsed the Naval Audit Service disclaimer of opinion on the FY 2000 Navy Working Capital Fund Financial Statements. This report discusses the reliability and effectiveness of the policies and procedures used to report intragovernmental transaction information for FY 2000 Navy Working Capital Fund Financial Statements.

Navy Working Capital Fund. The Navy Working Capital Fund finances six primary activity groups that provide support to the Navy and other authorized customers: Depot Maintenance, Transportation, Base Support, Information Services, Research and Development, and Supply Management. All of the primary activity groups except Supply Management are often referred to as the Industrial Fund business area. The Industrial Fund business area had 46 field organizations. The FY 2000 Navy Working Capital Fund Financial Statements reported \$25.1 billion in assets, \$6 billion in liabilities, and a net position of \$19.1 billion.

Accounting Functions and Responsibilities. The Defense Finance and Accounting Service (DFAS) Cleveland provides finance and accounting assistance to the Navy Working Capital Fund. Each month, DFAS Cleveland receives financial information in various forms from Navy Working Capital Fund field organizations and records the data into the Central Data Base (CDB) accounting system. DFAS Cleveland consolidates the financial data and prepares both the monthly reports and annual financial statements for the Navy Working Capital Fund. The CDB is primarily used for the compilation of data in summarized form received from various feeder systems. The feeder systems provide detailed transactions supporting trading partner information needed to report and eliminate the effects of intragovernmental transactions.

Transactions Requiring Elimination. Intragovernmental transactions are transactions that occur within and among DoD Components and agencies, and the Federal Government. When an entity prepares consolidated financial statements, it should remove the effect of financial transactions among its components and should report only transactions with outside parties. Navy Working Capital Fund organizations are routinely involved in transactions involving sales and purchases of materials and services with other Navy General Fund and Working Capital Fund organizations, DoD Components, and other Federal agencies. When those kinds of transactions occur, the transactions are to be disclosed, and when appropriate, eliminated from the various levels of

financial statements. With regard to sales of goods or services between Federal entities, there are three levels of intragovernmental transactions, which must be identified.

- Level 1: Transactions involving sales between DoD and other Federal agencies, such as between the Navy and the Department of Commerce.
- Level 2: Transactions involving sales between DoD reporting entities, such as between the Navy Working Capital Fund and the Navy General Fund.
- Level 3: Transactions involving sales between components of the DoD financial reporting entity, such as between the Navy Working Capital Fund Supply Management activity group and the Navy Working Capital Fund Depot Maintenance activity group.

The Navy Working Capital Fund is required to identify and report intragovernmental transactions for all levels. However, only intragovernmental transactions for level 3 are eliminated from the Navy Working Capital Fund financial statements. DFAS Cleveland identified and reported \$18.3 billion in intragovernmental transactions for levels 1, 2, and 3 for FY 2000. Of the \$18.3 billion, DFAS Cleveland eliminated \$4.7 billion in intragovernmental transactions related to level 3 from the FY 2000 Navy Working Capital Fund Financial Statements.

Objectives

The audit objective was to determine the reliability and effectiveness of the processes and procedures used to compile and prepare intragovernmental transactions for the FY 2000 Navy Working Capital Fund Financial Statements. We also reviewed the DFAS Cleveland management control program as it related to the audit objective. Appendix A discusses the audit scope and methodology and our review of the management control program.

A. Journal Vouchers for Intragovernmental Transactions

Review of the 151 journal vouchers (JVs) prepared by DFAS Cleveland showed that 95 JVs, valued at \$28.8 billion, were not adequately supported. In addition, DFAS Cleveland did not disclose in a note to the financial statements that accounts receivable and revenue were increased by \$295 million each so that abnormal balances caused by posting undistributed collections to accounts receivable would be removed. The JVs were prepared primarily because of the limitations of the accounting systems that do not capture trading partner information at the transaction level. DoD Regulation 7000.14-R directs DFAS Cleveland to force buyer-side data to agree with the seller-side data. Also, DFAS guidance did not require DFAS Cleveland to disclose the adjustment for negative accounts receivable. As a result, the financial statements could not be relied on. Until accounting systems can capture trading partner data, and reconciliations between buyers' and sellers' records can be performed, financial statements will continue to be unreliable.

Guidance for Reporting Intragovernmental Transactions

DoD Guidance. DoD Regulation 7000.14-R, "Financial Management Regulation," volume 6B, "Form and Content of the Department of Defense Audited Financial Statements," chapter 13, "Fiscal Year 2000 Adjustments, Eliminations, and Other Special Intragovernmental Reconciliation Procedures," October 2000, provides specific guidance and procedures for reporting and eliminating intragovernmental transactions. DoD Regulation 7000.14-R further states that DoD accounting systems do not capture trading partner information at the transaction level because DoD accounting systems were designed and implemented before the requirement to eliminate intragovernmental transactions was established. Therefore, the systems cannot produce the data necessary for reconciliations between buyers and sellers. DoD Regulation 7000.14-R also states that the amounts of intragovernmental accounts receivable, revenue, and advances from others (unearned revenue) reported by the seller are presumed to be more accurate. Therefore, corresponding amounts reported by the buyers for accounts payable, expenses, and advances must be adjusted to match the sellers' records.

DFAS Guidance. To avoid reporting negative accounts payable and accounts receivable prior to financial report preparation, DFAS issued interim guidance on March 1, 2001. This guidance allows the reporting activities to increase accounts payable and receivable to cover the negative amounts if the offset of undistributed disbursements or collections results in a negative amount. The interim guidance did not require the reporting activities to reconcile the differences nor to disclose the undistributed amounts applied to the financial statement line items. The interim guidance had not been approved by the Under Secretary of Defense (Comptroller) at the time of our review.

JVs Related to Intragovernmental Transactions

DFAS Cleveland and Kansas City prepared and posted 173 JVs, valued at \$37.5 billion, to the Defense Departmental Reporting System.¹ DFAS Cleveland prepared 151 JVs, valued at \$37 billion, and DFAS Kansas City prepared 22 JVs, valued at \$.5 billion. Review of the 151 JVs prepared by DFAS Cleveland showed that 56 JVs, valued at \$8.2 billion, were adequately supported. The remaining 95 JVs, valued at \$28.8 billion, were not supported because they were made to arbitrarily adjust accounts receivable, revenue, and unearned revenue to agree with the seller-side information, to adjust negative accounts receivable, or to reclassify the buyer-side data from Government to public.

Adjustments to Match Seller-Side Information. Because of the lack of reliable accounting systems, DFAS Cleveland could not use the information in the department-level general ledger accounts as a source for accumulating and reporting intragovernmental transactions. Instead, DFAS Cleveland used the seller information as a basis for reporting intragovernmental transactions. However, using the sellers' information to report intragovernmental transactions resulted in a series of adjustments because the amounts recorded for accounts receivable, revenue, and unearned revenue differed from the amounts recorded in the department-level general ledger accounts. For FY 2000, DFAS Cleveland posted 92 JVs, valued at \$28.2 billion, to force buyer-side data to agree with seller-side data or to reclassify the buyer-side data from Government to public. In preparing those JVs, DFAS Cleveland followed guidance in DoD Regulation 7000.14-R, which requires the buyer-side information be adjusted to match the seller-side information. DoD Regulation 7000.14-R further states that reconciliation between buyers and sellers records cannot be performed because existing DoD accounting systems cannot produce the data necessary for such reconciliations.

Increasing Accounts Receivable and Revenue. DFAS Cleveland increased accounts receivable and revenue by \$295 million each without adequately explaining the increased amount in the note to the financial statements. DoD Regulation 7000.14-R, volume 6B, states that where data used are known to be incomplete, deemed to be unreliable, or are estimated amounts, the note pertaining to the line(s) where such data are reported in the statement shall contain a reference to such data. DFAS Cleveland recorded three JVs that increased accounts receivable by \$295 million and revenue by \$295 million, without reconciling between the undistributed collections and the accounts receivable. These JVs were recorded to remove negative account balances resulting from posting undistributed collections to accounts receivable. In preparing the three JVs, DFAS Cleveland followed DFAS interim guidance on adjustments for negative accounts payable and accounts receivable, which directs DFAS Cleveland to make such adjustments if posting undistributed collections to accounts receivable creates a negative accounts receivable. This

¹The Defense Departmental Reporting System is a software application created during FY 2000 that was used to document ending trial balances from other accounting systems and adjustments necessary to produce a final trial balance and prepare the annual financial statements.

interim guidance was endorsed by the DFAS Director for Accounting on March 1, 2001, and submitted to the Under Secretary of Defense (Comptroller) for final approval. The interim guidance for handling negative accounts payable and accounts receivable had not been approved by the Under Secretary of Defense (Comptroller) at the time of our review. Accounts receivable should not be artificially increased unless there is a reconciliation between the undistributed collections and the accounts receivable. Accordingly, this departure from generally accepted accounting principles should be clearly disclosed in the notes to the financial statements.

Conclusion

We are not making a recommendation to correct the deficiencies related to accounting systems and the lack of reconciliation between buyers' and sellers' records because these deficiencies have been discussed in Inspector General, DoD, Report No. D-2000-144, "Compiling and Reporting FY 1999 Navy Working Capital Fund Intragovernmental Transactions," June 9, 2000, and Inspector General, DoD, Report No. D-2001-042, "Accounting and Disclosing Intragovernmental Transactions on the DoD Agency-Wide Financial Statements," January 31, 2001. The Under Secretary of Defense (Comptroller) concurred in principle with our recommendations to reconcile buyer and seller side information. However, because DoD accounting systems were not designed to capture such data, the Under Secretary of Defense (Comptroller) chose not to require such reconciliations. Both the FY 2000 Navy Working Capital Fund and FY 2000 DoD-Wide Financial Statements included a note to the financial statements disclosing that DoD was not able to reconcile intragovernmental transactions amounts with its trading partners, and buyer-side data were adjusted to equal with seller-side data. However, the inability of DoD to properly reconcile and report trading partner eliminations is a material weakness that may prevent the Navy Working Capital Fund financial statements and DoD-Wide financial statements from obtaining a favorable audit opinion.

Recommendation and Management Comments

A. We recommend that the Director, Defense Finance and Accounting Service, Cleveland, disclose in the notes to the financial statements journal voucher adjustments to accounts receivable and revenue made to remove abnormal account balances caused by posting undistributed collections to accounts receivable.

Management Comments. DFAS concurred and will disclose in a footnote to the financial statements the adjustments to accounts receivable and revenue to remove abnormal account balances caused by posting undistributed collections to accounts receivable.

B. Eliminations for Intragovernmental Transactions

Intragovernmental transactions shown as eliminated in the FY 2000 Navy Working Capital Fund Financial Statements were overstated by \$1.8 billion plus a potential additional amount up to \$2.2 billion. Also, DFAS Cleveland did not disclose its methodology for allocating intragovernmental transactions, and information submitted by one of the eight Navy field organizations reviewed was not accurate. These conditions occurred because of the following reasons.

- Eleven of the 46 Navy Working Capital Fund Industrial Fund organizations did not provide DFAS Cleveland with the seller-side information as required by DoD Regulation 7000.14-R. Accordingly, DFAS Cleveland extracted the seller-side information, valued at \$2.2 billion, for the 11 organizations from its general ledger and considered the entire amount as level 3 eliminations (transactions between different Navy Working Capital Fund organizations). (The 35 organizations that provided seller-side information showed that 91 percent of the intragovernmental transactions were with level 1 or 2 organizations--transactions with other DoD or Federal entities.)
- DFAS Cleveland erroneously omitted revenue-related transactions valued at \$2.1 billion when entering seller-side information for the 35 Navy Working Capital Fund organizations that provide the required seller-side information, because of inadequate controls over reviewing and posting of information received. DFAS Cleveland considered the entire \$2.1 billion as a level 3 elimination. However, the 35 organizations reported that \$1.8 billion were levels 1 and 2 intragovernmental transactions.
- Norfolk Naval Shipyard had not established controls to ensure the accuracy of intragovernmental transactions reported, and supporting records showed \$39 million more than what was reported.
- DFAS Cleveland did not follow guidance in DoD Regulation 7000.14-R, which requires that estimates reported in the financial statements be disclosed.

As a result, the FY 2000 financial statements for the Navy Working Capital Fund were materially misstated and could not be relied on to be a complete and accurate presentation of financial reporting.

Guidance for Eliminating Intragovernmental Transactions

Office of Management and Budget Guidance and Treasury Guidance.
Office of Management and Budget Bulletin No. 97-01, "Form and Content of Agency Financial Statements," October 16, 1996, as amended January 7, 2000,

requires agencies to show intra-entity eliminations for FY 2000. In September 2000, the Department of the Treasury issued a "Federal Intragovernmental Transactions Accounting Policies and Procedures Guide," which states that agencies should identify the differences, locate the information necessary to determine the causes of the differences, and quantify the amounts of the differences. Also, the agencies should prepare and record adjusting entries and document that adjusted accounts are reconciled.

DoD Guidance. In October 2000, the Under Secretary of Defense (Comptroller) issued guidance on intragovernmental eliminations and reconciliation procedures and incorporated the guidance into DoD Regulation 7000.14-R, "Financial Management Regulation," volume 6B, chapter 13. This guidance provides instructions to prepare and present worksheets in support of trading partner exchange of data and to adjust buyer-side information to agree with seller-side information. Also, the guidance provides instruction on how to compute intragovernmental transactions for levels 1, 2, and 3.

Standard Operating Procedures. In response to the recommendation in Inspector General, DoD, Report No. D-2000-144, DFAS Cleveland issued a standard operating procedure related to intragovernmental transactions. The standard operating procedure provides desktop procedures on how the elimination data are gathered and validated for FY 2000 Navy Working Capital Fund Financial Statements. The standard operating procedure also provides specific processes DFAS Cleveland should follow for analyzing and reviewing intragovernmental transactions.

Reporting Intragovernmental Transactions

During FY 2000, DFAS Cleveland identified and reported \$18.3 billion in intragovernmental transactions for levels 1, 2, and 3 in the FY 2000 Navy Working Capital Fund Financial Statements.

The following table shows the amounts of accounts receivable, revenue, and unearned revenue reported as intragovernmental transactions and eliminations for levels 1, 2, and 3 for FY 2000.

Summary of Seller Data Used for Intragovernmental Transactions (in thousands)				
Elimination Level	Accounts Receivable	Revenue	Unearned Revenue	Total
Level 1	\$ 66,287	\$ 389,965	\$ 21,370	\$ 477,622
Level 2	517,138	12,563,791	24,730	13,105,659
Level 3	301,386	4,374,664	10,054	4,686,104
Total	\$ 884,811	\$17,328,420	\$ 56,154	\$ 18,269,385

Of the \$18.3 billion, DFAS Cleveland eliminated \$4.7 billion in intragovernmental transactions related to level 3 from the FY 2000 Navy Working Capital Fund Financial Statements. However, the process DFAS Cleveland used to eliminate the \$4.7 billion in intragovernmental transactions in the FY 2000 Navy Working Capital Fund Financial Statements did not accurately identify and eliminate the effects of all intragovernmental transactions that occurred within and among Navy Working Capital Fund organizations, DoD, and other Federal agencies. DFAS Cleveland overstated level 3 eliminations by \$1.8 billion plus an undetermined amount up to \$2.2 billion.

Seller-Side Information From Field Organizations

DFAS Cleveland overstated level 3 eliminations by an undetermined amount up to \$2.2 billion because 11 of the 46 Navy Working Capital Fund Industrial Fund organizations that DFAS Cleveland requested to provide seller-side information for their trading partners did not provide the required information. Therefore, DFAS Cleveland decided to allocate the whole amount of intragovernmental transactions for these 11 organizations transactions to level 3 for elimination in the Navy Working Capital Fund financial statements. Also, seller-side information received from the field organizations was not always accurate.

Requesting Seller-Side Information. DoD Regulation 7000.14-R, volume 6B, requires DoD accounting centers and DoD Components to work internally, and with their customers, to extract seller-side information from their intragovernmental (DoD and Federal) trading partners. To comply with this requirement, DFAS Cleveland requested Navy organizations to modify their Summary Source of Revenue² (SSR) to include accounts receivable, revenue, and unearned revenue for all levels because the general ledger used for departmental accounting at DFAS Cleveland (the CDB), and the organizations' monthly general ledgers did not contain such detailed information.

For FY 2000, DFAS Cleveland sent a data call to 46 Navy Working Capital Fund Industrial Fund organizations to obtain the seller-side balances. Of the 46 organizations, 35 provided SSRs with detailed information on intragovernmental transaction balances for levels 1, 2, and 3 eliminations for accounts receivable, revenue, and unearned revenue amounts. The remaining 11 organizations did not provide DFAS Cleveland with the requested information and stated that their accounting systems were not capable of complying with the DFAS Cleveland request. We did not determine the capabilities of those 11 organizations. However, review of the FY 1999 intragovernmental transactions showed that the 11 Navy Working Capital Fund organizations did submit revenue information to DFAS Cleveland for FY 1999.

Allocation of Intragovernmental Transactions for Organizations Not Submitting Information. To compensate for the missing information, DFAS Cleveland used the financial information contained in the CDB to extract

²Summary Source of Revenue is the report generated by the Navy Industrial Fund organizations or by the DFAS operating locations. This report contains seller-side information for accounts receivable, revenue, and unearned revenue for levels 1, 2, and 3.

intragovernmental transactions for the 11 Navy Working Capital Fund organizations. The CDB data showed intragovernmental transactions relating to accounts receivable, revenue, and unearned revenue of \$142 million, \$2.1 billion, and \$8 million, respectively, for the 11 Navy Working Capital Fund organizations. Because the balances contained in the CDB did not include detailed information for levels 1, 2, and 3 eliminations, or Federal and non-Federal, DFAS Cleveland allocated the entire \$2.2 billion to level 3. This procedure resulted in overstating the eliminations for accounts receivable, revenue, and unearned revenue for level 3. Because trading partner information was not reported for 11 Navy Working Capital Fund organizations, the amount that should have been allocated to level 3 was not available. However, based on the breakout of transactions for the 35 organizations that did submit trading partner information, 91 percent was allocated to levels 1 and 2.

Accuracy of Information Received. The seller-side information provided by one of the Navy Working Capital Fund organizations reviewed contained errors. DoD Regulation 7000.14-R, volume 6A, "Reporting Policy and Procedures," chapter 2, December 2000, states that DoD Components shall establish appropriate internal controls to ensure that the data provided to DFAS are accurate, complete, and supportable. A judgmental sample of eight Navy Working Capital Fund organizations with the intragovernmental transactions of \$2.3 billion showed that seven of the eight Navy Working Capital Fund organizations had adequate support for the amount reported to DFAS Cleveland. However, one Navy Working Capital Fund organization—Norfolk Naval Shipyard—reported \$861 million to DFAS Cleveland although its records showed \$900 million or \$39 million more than the reported amount. We discussed this discrepancy with Norfolk Naval Shipyard accounting personnel and were told that they did not have the resources or the time to resolve the difference.

Compilation and Reporting of Intragovernmental Transactions for Elimination

Reviewing and Editing Financial Information Received. Review of the SSRs for the 35 organizations that submitted information used by DFAS Cleveland to compile intragovernmental transactions showed that DFAS Cleveland omitted \$2.1 billion while entering the SSR information into the CDB because of delays in receiving information from the 35 organizations. The \$2.1 billion included \$11.4 million in accounts receivable, \$2.05 billion in earned revenue, and \$5 million in unearned revenue. Consequently, the balance reported from the SSRs was less than the balance reported in the CDB. Because the CDB did not include information for levels 1, 2, and 3, or Federal and non-Federal, DFAS Cleveland decided to allocate the entire \$2.1 billion to level 3. However, \$1.8 billion of the \$2.1 billion were level 1 or 2 intragovernmental transactions, which should be eliminated from the DoD Agency-Wide or Government-Wide financial statements. As a result, level 3 eliminations were overstated by \$1.8 billion. If DFAS Cleveland had established controls for reviewing and editing financial information processed into the accounting system, these errors could have been identified and corrected.

Additional Disclosures. DoD Regulation 7000.14-R, volume 6B, states that where data used are known to be incomplete, deemed to be unreliable, or are an estimated amount, the note pertaining to the line(s) where such data are reported in the statement shall contain a reference to such data. DFAS Cleveland did not adequately explain in the footnote to the financial statements its procedures for allocating intragovernmental transactions for organizations that did not submit the required information. Additional disclosures in the footnote to the financial statements would make the intragovernmental eliminations for accounts receivable, revenue, and unearned revenue more useful and comply with DoD Regulation 7000.14-R.

Recommendations and Management Comments

B.1. We recommend that the Assistant Secretary of the Navy (Financial Management and Comptroller) and supporting Defense Finance and Accounting Service locations work together to provide the Summary Source Revenue data needed by Defense Finance and Accounting Service Cleveland to report intragovernmental transactions.

Management Comments. DFAS concurred and provided details on how they planned to obtain SSR data needed by DFAS Cleveland to report intragovernmental transactions.

Audit Response. Comments from DFAS were fully responsive. The Navy did not comment on the recommendation. We request that the Navy provide comments on the final report.

B.2. We recommend that the Assistant Secretary of the Navy (Financial Management and Comptroller) require Navy Working Capital Fund organizations to establish appropriate internal controls to ensure that the data provided to the Defense Finance and Accounting Service are accurate, complete, and supportable.

Management Comments Required. The Navy did not comment on the recommendation. Therefore, we request that they provide comments on the final report.

B.3. We recommend that the Director, Defense Finance and Accounting Service, Cleveland:

a. Improve management control procedures to ensure that financial information submitted from Navy Working Capital Fund field organizations is properly recorded, reviewed, and accounted for.

Management Comments. DFAS concurred and will improve management controls to help ensure that financial information submitted by the Navy Working Capital Fund field organizations is properly recorded, reviewed, and accounted for. However, due to the manual effort involved, there will continue to be a risk of errors occurring in compiling and reporting the information.

b. Disclose in an appropriate footnote to the financial statements the methodology for allocating intragovernmental transactions for organizations that do not submit the required seller-side information.

Management Comments. DFAS concurred and stated that personnel from the Working Capital Fund Policy and Procedures section have been assigned to work with Navy Working Capital Fund field organizations to create a process by October 31, 2001, to help ensure that required seller-side information is submitted to DFAS. If this information is not submitted, DFAS will disclose in a footnote to the financial statements the method used to allocate seller-side balances for organizations that did not submit the required information.

Appendix A. Audit Process

Scope

We reviewed the process DFAS Cleveland used to identify and report intragovernmental transactions for the FY 2000 Navy Working Capital Fund Financial Statements, including the balance sheet, Statement of Net Cost, and Statement of Changes in Net position. DFAS Cleveland and Kansas City recorded 173 JVs, valued at \$37.5 billion. We reviewed 151 of the 173 JVs, valued at \$37 billion, prepared by DFAS Cleveland to reflect the seller-side information. We did not review the remaining 22 JVs, valued at \$.5 billion, made by DFAS Kansas City. Also, we judgmentally selected and reviewed the documentation supporting the SSRs for eight Navy Working Capital Fund organizations with the intragovernmental transactions of \$2.3 billion to determine whether the information provided to DFAS Cleveland was accurate and reliable.

DoD-Wide Corporate Level Government Performance and Results Act Goals. In response to the Government Performance and Results Act, the Secretary of Defense annually establishes DoD-wide corporate-level goals, subordinate performance goals, and performance measures. This report pertains to achievement of the following corporate-level goal, subordinate performance goal, and performance measures.

- **FY 2001 DoD Corporate-Level Goal 2:** Prepare now for an uncertain future by pursuing a focused modernization effort that maintains U.S. qualitative superiority in key warfighting capabilities. Transform the force by exploiting the Revolution in Military Affairs, and reengineer the Department to achieve a 21st century infrastructure. **(01-DoD-2)**
- **FY 2001 Subordinate Performance Goal 2.5:** Improve DoD financial and information management. **(01-DoD-2.5)**
- **FY 2001 Performance Measure 2.5.1:** Reduce the number of noncompliant accounting and finance systems. **(01-DoD-2.5.1)**
- **FY 2001 Performance Measure 2.5.2:** Achieve unqualified opinions on financial statements. **(01-DoD-2.5.2.)**

DoD Functional Area Reform Goals. Most major DoD functional areas have also established performance improvement reform objectives and goals. This report pertains to achievement of the following functional area objective and goal.

Financial Management Area. Objective: Strengthen internal controls. **Goal:** Improve compliance with the Federal Managers' Financial Integrity Act. **(FM-5.3)**

General Accounting Office High-Risk Area. The General Accounting Office has identified several high-risk areas in the DoD. This report provides coverage of the Defense Financial Management high-risk area.

Methodology

We reviewed applicable laws, policies, procedures, and regulations related to the preparation and presentation of intragovernmental eliminating transactions for the FY 2000 Navy Working Capital Fund Financial Statements. We reviewed the DFAS Cleveland accounting records and accounting adjustments, and we held discussions with DFAS Cleveland and Navy Working Capital Fund organizations accounting personnel responsible for collecting, reviewing, exchanging, and reporting intragovernmental transactions. We compared and analyzed the information that DFAS Cleveland obtained from other trading partners with the information reported in the financial statements. Also, we reviewed and compared the seller information received by DFAS Cleveland to their source documentation for accuracy and completeness.

Use of Computer-Processed Data. We relied on computer-processed data from Standard Accounting and Reporting System-Financial and Departmental Reporting, Defense Departmental Reporting System, Standard Accounting and Reporting System-Field Level, Standard Accounting and Reporting System-Headquarters Command Module, and CDB to conduct the audit. We relied on computer-processed data without performing tests of the system's general and application controls because the process for accumulating and reporting intragovernmental eliminating transactions at DFAS Cleveland is primarily a manual process. Not evaluating the controls did not affect the results of the audit.

Audit Type, Dates, and Standards. We performed this financial-related audit from October 2000 through March 2001 in accordance with auditing standards issued by the Comptroller General of the United States, as implemented by the Inspector General, DoD. We did our work in accordance with generally accepted Government auditing standards except that we were unable to obtain an opinion on our system of quality control. The most recent external quality control review was withdrawn on March 15, 2001, and we will undergo a new review.

Contacts During the Audit. We visited or contacted individuals and organizations in DoD. Further details are available on request.

Management Control Program Review

DoD Directive 5010.38, "Management Control (MC) Program," August 26, 1996, and DoD Instruction 5010.40, "Management Control (MC) Program Procedures," August 28, 1996, require DoD organizations to implement a

comprehensive system of management controls that provides reasonable assurance that programs are operating as intended and to evaluate the adequacy of the management controls.

Scope of the Review of the Management Control Program. We reviewed the adequacy of the DFAS Cleveland management controls over accumulating and reporting intragovernmental transactions that occurred within the Navy General Fund, Navy Working Capital Fund, DoD Components, and other Federal Government agencies. Specifically, we reviewed the procedures and controls that DFAS Cleveland used to collect, adjust, reconcile, allocate, and report intragovernmental accounts receivable, revenue, and unearned revenue. We reviewed management's self-evaluation applicable to those controls.

Adequacy of Management Controls. We identified material management control weaknesses as defined by DoD Instruction 5010.40. Because of inadequate accounting systems, JVs recorded by DFAS Cleveland to adjust buyer-side data to agree with seller-side data could not be supported. This management control weakness has already been identified. The Assistant Secretary of the Navy (Financial and Comptroller) acknowledged in its management representation letter for the FY 2000 Navy Working Capital Fund Financial Statements that intragovernmental transactions and balances have not been appropriately identified and eliminated for financial reporting purposes because of deficiencies in the systems and reporting processes. Also, DFAS Cleveland management controls over reviewing, compiling, and allocating intragovernmental transactions were not adequate to ensure that intragovernmental transactions and eliminations were correctly reported. Recommendation B.3.a., if implemented, will improve management controls over reliability of the financial reporting. A copy of this report will be provided to the senior official responsible for management controls at DFAS Cleveland.

Adequacy of Management's Self-Evaluation. DFAS Cleveland's self-evaluation did not detect and report management control weaknesses related to its review and compilation of intragovernmental transactions because DFAS Cleveland did not assess the reviewing and recording financial information received from the Navy Working Capital Fund organizations as a part of its internal control program.

Prior Coverage

The General Accounting Office and the Inspector General, DoD, have conducted multiple reviews related to financial statement issues. General Accounting Office reports can be accessed on the Internet at <http://www.gao.gov>. Inspector General, DoD, reports can be accessed on the Internet at <http://www.dodig.osd.mil/audit/reports>.

Appendix B. Report Distribution

Office of the Secretary of Defense

Under Secretary of Defense (Comptroller)
Deputy Chief Financial Officer
Deputy Comptroller (Program/Budget)

Department of the Army

Auditor General, Department of the Army

Department of the Navy

Assistant Secretary of the Navy (Financial Management and Comptroller)
Assistant Secretary of the Navy (Manpower and Reserve Affairs)
Naval Inspector General
Auditor General, Department of the Navy

Department of the Air Force

Auditor General, Department of the Air Force

Other Defense Organizations

Director, Defense Finance and Accounting Service Arlington
Director, Defense Finance and Accounting Service Cleveland
Director, Defense Finance and Accounting Service Kansas City

Non-Defense Federal Organization

Office of Management and Budget

Congressional Committees and Subcommittees, Chairman and Ranking Minority Member

Senate Committee on Appropriations
Senate Subcommittee on Defense, Committee on Appropriations
Senate Committee on Armed Services
Senate Committee on Governmental Affairs
House Committee on Appropriations
House Subcommittee on Defense, Committee on Appropriations
House Committee on Armed Services
House Committee on Government Reform
House Subcommittee on Government Efficiency, Financial Management, and Intergovernmental Relations, Committee on Government Reform
House Subcommittee on National Security, Veterans Affairs, and International Relations, Committee on Government Reform
House Subcommittee on Technology and Procurement Policy, Committee on Government Reform

Defense Finance and Accounting Service Comments



DFAS-DAS

DEFENSE FINANCE AND ACCOUNTING SERVICE


1931 JEFFERSON DAVIS HIGHWAY
ARLINGTON, VA 22240-5291

MAY 25 2001

MEMORANDUM FOR DIRECTOR, FINANCE AND ACCOUNTING DIRECTORATE,
OFFICE OF THE INSPECTOR GENERAL, DEPARTMENT OF
DEFENSE

SUBJECT: Audit Report on Compiling and Reporting FY 2000 Navy Working Capital Fund
Intragovernmental Transactions (Project No. D2000FC-0279.002)

Our response to the subject audit is attached. The point of contact is Mr. David Arvin,
(703) 607-2857 or DSN 327-2857.


Robert P. McNamara
Director for Accounting

Attachment:
As stated

cc:
DFAS-DDI
DFAS-AJIS/CL

DFAS Comments on Audit Report on Compiling and Reporting FY 2000 Navy Working Capital Fund Intragovernmental Transactions (Project No. D2000FC-0279.002)

Response to Recommendations

Recommendation A. We recommend that the Director, Defense Finance and Accounting Service, Cleveland, disclose in notes to the financial statements journal voucher adjustments to accounts receivable and revenue made to remove abnormal account balances caused by posting undistributed collections to accounts receivable.

Management Comments. Concur. The Defense Finance and Accounting Service (DFAS) Cleveland will footnote in the financial statements journal voucher adjustments to accounts receivable and revenue to remove the abnormal account balances caused by posting undistributed collections to accounts receivable.

Estimated Completion Date. October 31, 2001.

Recommendation B.1. We recommend that the Assistant Secretary of the Navy (Financial Management and Comptroller) and supporting Defense Finance and Accounting Service locations work together to provide the Summary Source Revenue data needed by Defense Finance and Accounting Service Cleveland to report intragovernmental transactions.

Management Comments. Concur. The DFAS Cleveland field sites are working with DFAS Cleveland to provide summary source revenue data through the course of normal business operations, including special data requirements upon request.

Estimated Completion Date. October 31, 2001.

Recommendation B.3. We recommend that the Director, Defense Finance and Accounting Service, Cleveland:

a. Improve management control procedures to ensure that financial information submitted from Navy Working Capital Fund field organizations is properly recorded, reviewed, and accounted for.

Management Comments. Concur. DFAS Cleveland will improve management control procedures to ensure that financial information submitted from Navy Working Capital Fund field organizations is properly recorded, reviewed and accounted for. However, the process, as it currently exists, to capture this information is strictly a manual effort that involves a significant amount of data. Even with management controls and procedures in place, due to the manual effort involved, there is the risk of errors occurring in compiling and reporting this information.

Estimated Completion Date. October 31, 2001.

b. Disclose in appropriate footnote to the financial statements the methodology for allocating intragovernmental transactions for organizations that do not submit the required seller-side information.

Management Comments. Concur. Personnel from Working Capital Fund Policy and Procedures section have been assigned to work with the Navy Working Capital Fund field organizations to create a process to ensure that the required seller-side information is submitted to us. In the event that this information is not submitted, DFAS Cleveland will disclose in a footnote to the Audited Financial Statements the method used to allocate seller-side balances for those activities that do not submit the required information.

Estimated Completion Date. October 31, 2001.

Audit Team Members

The Finance and Accounting Directorate, Office of the Assistant Inspector General for Auditing, DoD, prepared this report. Personnel of the Office of the Inspector, DoD, who contributed to the report are listed below.

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